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ABSTRACT

To improve the equity of Vermont's school finance system, the state legislature passed Act 60. This new funding mechanism is described, with a focus on the equity issues raised by the state supreme court. A court's decision struck down substantial dependence on local property taxes to provide revenue for local school districts. The report reviews the background of the case and describes how the court explained its position. The focus, however, is on the changes that the decision wrought in the finance system and the potential implications of these changes for school finance equity in the future, particularly the income-sensitive property tax provision that makes Vermont's system unique. The analysis centers on the basic structure of the reform--the block grant--which is funded through a statewide property tax. Ways to distribute these funds, such as through weighted pupil counts, were also reformed, and a process called an "equalized second tier" was implemented, which is a local option tax that is determined on the basis of the individual budget decisions made by local school boards. The transition to the new tax system and the categorical programs that are in place are described. (RJM)

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Income Sensitive Property Taxes And School Finance Reform in Vermont

> In this appeal, we decide that the current system for funding public education in Vermont, with its substantial dependence on local property taxes and resultant wide disparities in revenues available to local school districts, deprives children of an equal educational opportunity in violation of the Vermont Constitution.
>
> *Brigham v. State of Vermont*

With these words on February 5, 1997, the Supreme court of Vermont changed forever the way public schools in the Green Mountain State are organized and funded. By June of 1997, the Vermont Legislature had enacted sweeping new legislation designed to meet the Court's requirements and to dramatically improve the equity of that state's school finance system. While primarily establishing a new funding system, Act 60, as that legislation is known, has a number of "quality components" designed to improve student performance as well. Proulx and Jimmerson (1998) argue that combined with the new financial system, Act 60 represents a dramatic change in the way school business is conducted in Vermont. This paper focuses on the fiscal provisions of Act 60.

The school funding system established by Act 60 places more responsibility for raising school revenues at the state level. At the same time, the system establishes a "block grant" base level of funding for all schools, and creates a guaranteed yield second tier to allow districts to spend above the base level. The fiscal components of Act 60 are to be implemented over four years beginning in FY 1998 and continuing through 2001. During the current (1998) fiscal year, the state's old system is largely in place, with the state providing additional funding. By 2001, all of the fiscal provisions of the Act are to be in place.

This paper describes the new funding mechanism for Vermont schools, focusing on the equity issues raised by the State Supreme Court and discussion how those concerns were addressed in Act 60. The first section of the paper describes the Court's Decision in *Brigham* focusing on the school finance implications of the ruling. The second section of the paper describes the finance system established under Act 60. Act 60's finance provisions do not really begin to be implemented until next year (FY 1999). Consequently, detailed school finance equity estimates are not yet possible. Instead, this paper focuses on the changes in the finance system, and their potential implications for school finance equity in the future. Of particular importance to this discussion is the income sensitive property tax provision that make's Vermont's system unique among the 50 states. Finally, the last section of this paper offers some conclusions and policy implications arising from the implementation of Vermont's new school finance system.

THE COURT RULING

Background

One of the unusual aspects of the *Brigham* case is the speed with which the Vermont Supreme Court reached its decision. School Finance litigation in most states takes years to wind its way through the court system. Often the funding system in place when the suit was originally filed has been changed considerably by the state legislature in the meantime. However, in Vermont, the entire process, from initial filing to the enactment of Act 60, took less than a year.[1]

[1] The material that follows regarding the timing the court proceedings is based on personal conversations with Robert Gensburg, plaintiff's attorney, and William Reedy, counsel for the Vermont Department of Education.

The *Brigham* case was initially filed in September of 1996 in Superior Court. The state sought and received a summary judgement dismissing the case. This was appealed to the Vermont Supreme Court and oral arguments were heard in December, 1996. Although both sides argued for a trial to establish the facts, the high court determined that adequate facts already existed, and elected to rule on the matter without a trial (*Brigham* p. 4). The ruling in *Brigham* was made public on February 5, 1997.

Although the speed with which the ruling in Brigham was made is unusual, the Vermont Legislature also acted with much more dispatch than is often observed in the case of school finance reform. Act 60 was passed and signed by the Governor before the end of June, 1997. In part this was possible because school finance reform had been a major policy issue in the Legislature for a number of years. As a result, many ideas had been proposed and analyzed, and there was substantial knowledge about school finance issues among both the Legislature's leadership and many of its members. The added impetus of the court ruling finally brought about passage of the new system.

What the Court Said

The plaintiffs in the *Brigham* case filed suit claiming that the then existing system of funding schools in Vermont violated the Education and Common Benefits Clauses of the Vermont Constitution (Specifically Vermont Constitution ch. I, art. 7 and ch. II, section 68). Section 68 specifically states that:

> Laws for the encouragement of virtue and prevention of vice and immorality ought to be constantly kept in force, and fully executed; and a competent number of schools ought to be maintained in each town unless the general assembly permits other provisions for the convenient instruction of youth. (*Brigham*, p. 2-3)

The court held that:

> When we consider the evidence in the record before us, and apply the Education ad Common Benefits Clauses of the Vermont Constitution to that evidence, ..., the conclusion becomes inescapable that the present system has fallen short of providing every school-age child in Vermont an equal educational opportunity. (*Brigham*, p. 1)

The Court cited substantial evidence of inequities in the state's school funding system, including the high percentage of local funding (over 60%), the considerable disparity in per pupil spending across the state (a low of $2,979 to a high of $7,726). The Court went on to cite a number of traditional school finance statistics related to per pupil spending, taxable wealth and taxes paid to show that there were considerable inequities in the system.

The Court argued that much of the problem could be attributed to the state's foundation program for financing schools. A foundation program, typical of many state finance programs, establishes a base funding level and guarantees that each district will have at least that level of funding if it enacts a minimum tax rate. The problem in Vermont, as pointed out by the Court, was that the foundation level had not kept pace with school district expenditures. Quoting from Odden and Picus (1992), the court stated that "From an equity standpoint, the major weakness of a foundation formula distribution system is that it equalizes capacity only to a level of a minimally adequate education program" (*Brigham*, p. 6). This statement was important as it led the Legislature to believe the Court told them to find an alternative to the foundation program. The result, as described below, was a block grant – which and enacted in Vermont is essentially a foundation formula with a different name.

The strength of the Court's ruling is found in the discussion of the facts on p. 9 where the justices state:

> We now turn to the chief contention of this dispute, namely whether the disparities in educational opportunities outlined above violate Vermont law. We find the law to be unambiguous on this point. Whether we apply the "strict scrutiny" test urged by plaintiffs, the "rational basis" standard advocated by the State, or some intermediate level of review, the conclusion remains the same; in Vermont the right to education is so integral to our constitutional form of government, and its guarantees of political and civil rights, that any statutory framework that infringes upon the equal enjoyment of that right bears a commensurate heavy burden of justification. The State has not provided a persuasive rationale for the undisputed inequities in the current educational funding system. Accordingly, we conclude that the current system, which concededly denies equal educational opportunities, is constitutionally deficient. (*Brigham*, p.9)

In holding the system unconstitutional, the Court seemed less concerned with the particular constitutional provision it relied upon, and more concerned with what it considered to be the "gross inequities" of the existing system. Specifically, the court said:

> This is not a case, however, that turns on the particular constitutional text to be employed. Labels aside, we are simply unable to fathom a legitimate governmental purpose to justify the gross inequities in educational opportunities evident form the record. The distribution of a resource as precious as educational opportunity may not have as its determining force the mere fortuity of a child's residence. It requires no particular constitutional expertise to recognize the capriciousness of such a system. (*Brigham*, p. 20).

Within this context, the Court did not require exact equality of funding. In fact, the Court clearly anticipated that:

> The Constitution does not, to be sure, require exact equality of funding among school districts or prohibit minor disparities attributable to unavoidable local differences. As we have seen, however, that is not the situation we confront. On the contrary, the evidence discloses substantial interdistrict funding disparities, despite the efforts of the State through the comprehensive state-aid program. (*Brigham*, p. 22)

The court then concluded:

> In so holding we emphasize that absolute equality of funding is neither a necessary nor practical requirement to satisfy the constitutional commend of equal educational opportunity... Equal opportunity does not necessarily require precisely equal per-capita expenditures, or does it necessarily prohibit cities and towns from spending more on education if they choose, but it does not allow a system in which educational opportunity is necessarily a function of district wealth. (*Brigham* p. 23)

In summary, the Court found that Vermont's school funding system violated the Education and Common Benefits Clauses of the state constitution, and required that the state's general assembly take action to correct the deficiencies of the system. In short, the Court required the state to insure that a school district's spending was a function of the wealth of the entire state, and not just of the town in which the district was located. Act 60 was the result.

FINANCE PROVISIONS OF ACT 60

Act 60 enacted sweeping changes to the way Vermont's schools are financed. The basic structure is a block grant (similar in operation to a foundation program), and a second tier guaranteed yield. The system relies on a weighted pupil count similar to one that had been in place before. In addition, there are categorical programs for special education, school construction, debt service, transportation, and small schools. The provisions of Act 60 are to be implemented over a four year period, with the first major changes in property tax collection beginning in fiscal year 1999. The following subsections describe the various financial components of Act 60.

The Block Grant

The first tier of the new system is a block grant, named such mostly because of the criticism of foundation programs contained in the Court's ruling in *Brigham*. The

block grant is funded through a state-wide property tax of $1.10 per $100 of assessed valuation on all property in the state. This is used, along with state resources, to fund a block grant of approximately $5,000 per weighted pupil for every district in the state.

What makes this program unique is the income sensitive component of the property tax. Although the property tax is levied uniformly on all property in the state, it is limited for households with "modified adjusted gross incomes" under $75,000. Property tax liability on a primary residence and up to two acres is limited to either two percent of household income, or to the tax due on the property after taking a $15,000 exemption from the fair market value of the house and up to two acres of property. Whichever calculation results in a lower property tax bill will be used. Since it was estimated that in 1996, 88 percent of households in Vermont had incomes below $75,000, this provision has wide implications for property tax bills.

The Weighted Pupil Count

Vermont has always relied on a weighted pupil count to distribute funds. However, since state was a relatively low portion of total revenue, weights did not have the significance they do now that the state distributes the first $5,000 in funding to all districts on the basis of this weighted pupil count.

Each elementary student is weighted as 1.0, while Secondary students (grades 9-12) receive a weight of 1.25. In addition, a weight of an additional 0.25 times the poverty ratio of the district is calculated. The poverty ratio is defined as the proportion of families in the district receiving food stamps. An additional weight of 0.2 is used for each limited English proficient student.

The calculation is further complicated by the determination of the total number of equalized pupils which is determined by an equalization ratio applied to the districts weighted average daily membership. This ratio is determined by dividing the average daily membership of the state by the weighted average daily membership of the state. In 1997, the equalization ratio was 0.87. This process determines how many pupil units a district has to generate block grants.

The Equalized Second Tier

Since some 89 percent of Vermont school districts spent more than $5,000 per pupil in 1996-97, a second equalized tier is included in the provisions of Act 60. This so-called local option tax is determined on the basis of the individual budget decisions made by local school boards. Once all of the districts have determined how much they want to spend above the block grant, a state-wide tax rate is determined and levied by all districts choosing to spend more than the block grant. Funds are recaptured from districts that raise more than they need from this tax, and distributed to districts that raise less than they need with this tax.

What is important to understand is that the second tier is entirely funded through these local property taxes, the state does not contribute to this spending. Thus, spending above the block grant minimum is funded entirely by equalized property taxes levied by all districts choosing to spend above the block grant.

Since a district's tax rate won't be determined until all district budget votes are complete, there is considerable concern over the impact of the second tier on property tax rates, particularly in high wealth districts who are the ones most likely to find themselves with considerably higher tax rates.

To insure that tax burdens do not become too high, Act 60 contains a "super circuit breaker" feature to insure that no household pays more than five percent of total income for all school and municipal property taxes. A sliding scale limits the total property tax bill as follows (Nelson, Francis & Gilbert, 1997):

- $0-4,999 – 3.5 percent
- $5,000-$9,999 – 4.0 percent
- $10,000-24,999 – 4.5 percent
- $25,000-47,00 – 5.0 percent

Transition to New Tax System

As indicated above, the finance provisions of Act 60 go into effect for fiscal year 1999. A series of caps reduce tax increases in low-tax towns and reduce tax decreases in high tax towns for fiscal year 1999 as follows (Nelson, Francis & Gilbert, 1997):

- For towns with a fiscal year 1997 school property tax rate of $0.20 or less, the statewide rate will be the town's fiscal year 1997 rate plus one-third of the difference between that rate and $1.10.
- For towns with a fiscal year 1997 school property ax rate between $0.21 and $1.09, the state rate will be the fiscal year 1997 rate plus $0.30 or $1.10, whichever is less.
- For towns with a fiscal year 1997 tax rate for schools over $1.10 to $1.14, the state rate will be $1.10.
- For towns with a fiscal year school property tax rate of $1.15 for more the state rate will be $1.15.

Finally, for fiscal year 1999, no town will be required to raise its combined school and municipal property tax rate by more than 40 percent over the combined fiscal year 1998 rate. Limits are also placed on how much towns much pay to, or draw from, the state education fund in fiscal year 1999 based on their property wealth per pupil. Districts with

wealth over $15,000 per pupil will pay half of tax revenues raised from nonresidential property into the sate education fund. Towns with above average wealth but less than $15,000 per pupil will pay into the state fund on a sliding scale yet to be determined, and districts with wealth below the state average will receive up to 75 percent assistance for taxes above the state-wide tax rate.

Still undetermined is how the transition assistance will be implemented in fiscal year 2000. This is up to the 1998 Legislature, and even the various caps for fiscal year 1999 could be changed before the session is over. By 2001 the provisions of Act 60 are to be fully implemented.

Categorical Programs

There are a number of categorical programs that are part of the new finance system as well. Each is described briefly below.

Special Education

Funding for special education in Vermont is generally the same as before, with districts receiving funds for special education based on total enrollment. Beginning in fiscal year 1999, this will amount to approximately $226 per equalized pupil. This $226 is part of the district's block grant. In addition, the threshold for extraordinary services reimbursement to a school district will be increased from $16,258 to $50,000. This means that special education service costs below $50,000 are the responsibility of the district, and the state will pay the costs of services above that amount.

School Construction Aid

Act 60 provides that the state will contribute 30 percent of the costs of all state-approved construction projects. In addition, the state currently provides wealth-related

assistance for payment on bonded indebtedness. This provision is eliminated under Act 60, although the Commissioner has been directed to study the impact of this provision before the 1999 fiscal year.

Transportation Aid

Under Act 60, the goal of the state is to pay for 50 percent of transportation costs. The Legislature will appropriate approximately $10 million for fiscal year 1999 and then that amount will be adjusted for inflation annually after that. Thus, it is not clear what percentage of total costs will actually be financed by the state. However, the $10 million represents a substantial increase over the state's current commitment to transportation funding. An additional $500,000 is expected to be appropriated for fiscal year 1999 for extraordinary transportation costs. The state board of education must determine what these are before the funds can be used.

Small School Support

Finally, Act 60 provides support for small schools, those with enrollments of under 100. The aid is determined by multiplying the school's long term average daily membership by $500 and subtracting the amount form $50,000. The grant is limited to a maximum of $2,500 per student (Nelson, Francis & Gilbert, 1997).

CONCLUSIONS AND POLICY IMPLICATIONS

Act 60 represents a dramatic change in the way Vermont's schools are funded. The system promises to improve on the equity of the system that the Supreme Court held unconstitutional, and should make district revenues much more a function of the state's wealth and less a function of their own wealth. However, the funding level for the block

grant is substantially below what most districts in the state current spend. Moreover, the equalized yield in the second tier is funded entirely from local property tax collections redistributed among those districts that elect to spend above the block grant.

While this has positive implications for low wealth districts who will now have access to greater wealth in determine how much they want to raise and spend for the education of their children, high wealth districts may face a difficult dilemma. For the wealthiest of districts (typically those with the highest spending levels as well), even the $1.10 state property tax represents an increase. They have no choice about that. However, if they want to continue to spend more than the $5,000 provided by the block grant, they not only have to raise property taxes by a state determined amount, they may have to contribute a substantial portion of those tax collections to other districts. The only way they can avoid this is to keep expenditures at the level of the block grant. What they will decide to do has important consequences for all districts.

Although the Legislature raised some $58 million in new taxes for fiscal year 1998 and beyond to help fund education, it seems clear that absent some additional state aid for the second tier of the system, it is destined to fail. The implications of this for the constitutionality of the system Act 60 created are hard to determine, but unlikely to help a great deal.

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